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Legal Guide K-5

CALIFORNIA'S BAD CHECK LAW

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A OVERVIEW OF BAD CHECK LAW

1. Claim for Statutory Penalty

Under California's Bad Check Law,¹ a person who has written a check to another person or business can be required to pay the amount of the check and either a service charge or a penalty if the check is returned by the bank due to insufficient funds. The person who wrote the check is called the drawer and the person or business who accepted the check is called the payee.

More particularly, the Bad Check Law states that the drawer must pay to the payee the following amounts:

(a) the face amount of the check, plus a statutory service charge; or, if the drawer does not pay this total in full, then --

(b) upon the payee's proper written demand for payment, the face amount of the check, plus a statutory service charge, plus the costs to mail the demand for payment; or, if the drawer does not pay this total in full within 30 days, then --

(c) if the payee has made a proper written demand for payment, and the drawer has not paid to the payee, within 30 days of the demand, the total at (b), then --

(i) the face amount of the check, plus

(ii) a statutory penalty of three times the face amount of the check, but not less than \$100 nor more than \$1,500.² (See pages 2-3 on the effect of a partial payment made during the 30 days.)

Several limits apply: (a) The payee of the check cannot recover both a service charge and a statutory penalty. (b) The payee cannot recover either of these unless certain conditions described in this Legal Guide have been met. (c) Only one

statutory penalty can be recovered with respect to the same check. (d) Interest

cannot be claimed if either a service charge or a penalty is claimed. (e) Multiple recoveries for the same loss are not allowed.

See the detailed discussion of the statutory penalty in part B., pages 2-6.

2. Claim for Service Charge

The payee of a check that has been returned for insufficient funds can require the drawer to pay the payee the face amount of the check and a service charge of up to \$25 for the first check and up to \$35 for each subsequent check to that payee that is returned for insufficient funds.³

However, the drawer of the check is not liable for a service charge in any of the following situations:

! Bank error -- if the drawer presents the payee with written confirmation from the drawer's bank that the check was returned to the payee due to the bank's error.⁴

! Delay in automatic deposit -- if the drawer provides the payee with written evidence that the drawer's account had insufficient funds due to a delay in the regularly scheduled transfer or posting of a direct deposit of a social security or government benefit assistance payment.⁵

! Service charge already imposed -- if a service charge has already been charged with respect to that check.

The drawer also is not liable for a service charge if the payee has mailed the drawer a proper written demand for a statutory penalty under the Bad Check Law, and the drawer has failed to pay the amount of the check, the service charge and the mailing costs within 30 days after the mailing. Instead, the drawer is liable for the

amount of the check and the statutory penalty.

See the detailed discussion of the service charge in part C., pages 6-7.

B CLAIM FOR STATUTORY PENALTY

1. Payee's Right to Statutory Penalty

a. General Rule

A drawer who passes a check on insufficient funds, and who fails to pay the payee, within 30 days after the payee mails the drawer by certified mail a proper written notice demanding payment (see c., below), is liable to the payee for the face amount of the check and a statutory penalty if all of the statutory prerequisites (discussed below) are met.⁶

If the payee makes a proper written demand to the drawer of the check, and the drawer does not pay, within the 30 days, the total of the face amount of the check, the service charge, and the costs to mail the written demand, then the drawer is liable to the payee for --

(1) the face amount of the check, minus any partial payments toward the amount of the check or the service charge, made within 30 days of the written demand, plus

(2) a statutory penalty equal to three times the balance in (1), but not less than \$100 nor more than \$1,500.⁷

Only one statutory penalty is recoverable with respect to the same check.⁸

b. "Insufficient Funds" Defined

A statutory penalty is available when a check is "passed on insufficient funds." This means that the drawer has written a check that the bank has refused to honor for any of the following reasons:

(1) lack of funds or credit in the drawer's account; (2) absence of an account; or, (3) the drawer's stop payment order.⁹

The payee must follow different procedures depending on the reason that the check was returned. (See page 4 (lack of funds or credit, or absence of an account), and pages 4-6 (stop payment order).)

c. Written Demand by Certified Mail Required

A drawer of a check that is returned for insufficient funds¹⁰ is liable for a statutory penalty under the Bad Check Law only if the payee sends

a proper written demand to the drawer by certified mail, requesting payment within 30 days.¹¹ If the demand is properly addressed and mailed, the drawer need not actually receive it.

The function of the written demand for payment is to encourage the drawer of the check to promptly pay the face amount of the check (plus a service charge, and the costs of mailing the demand) and thereby avoid liability for the statutory penalty.

The required contents of the written demand for payment are discussed at page 4 (where check returned for lack of funds or credit, or absence of an account) and at pages 4-6 (if drawer stopped payment).

d. Credit for Timely Partial Payments

If the drawer makes any partial payment toward the amount of the check or the service charge within the 30 days, the base on which the statutory penalty is calculated becomes the face amount of the check minus any partial payment made.¹²

A partial payment made after the 30-day period reduces the payee's claim for the face amount of the check, but not the statutory penalty.

e. Formulas for Calculating Amounts

(1) Statutory penalty. The statutory penalty (subject to the \$1,500 ceiling and \$100 floor) can be calculated as follows: (a) begin with the face amount of the check, then (b) subtract any payments made by the drawer within 30 days of mailing the demand for payment, and then (c) multiply the remainder by three. If the product is over \$1,500, reduce it to \$1,500; if the product is under \$100, increase it to \$100.

(2) Total payment to payee. The total payment to the payee (the face amount of the check plus the statutory penalty) can be calculated as follows:

(A) for checks up to \$33.33: check + \$100;

(B) for checks from \$33.34 to \$500: 4 times the check;

(C) for checks over \$500: check + \$1,500.

f. No Judgment for Payee's Service Charge and Other Losses

If the payee has mailed a proper written demand by certified mail, and the drawer of the check has not paid, within 30 days, the total of the

face amount of the check, the service charge payable to the payee, and the costs to mail the written demand, the drawer is obligated to pay a statutory penalty, but not a service charge or the costs of mailing the demand.¹³

The statutory penalty is not only a penalty. It also compensates the payee for any losses for which the service charge provided compensation, such as (1) delay in receiving payment, (2) the returned check fee paid by the payee to its own financial institution, (3) the inconvenience and added expense of processing the returned check, and (4) any other losses.

g. Double Recoveries Barred

The law generally bars multiple recoveries for the same loss. For instance: (1) the face amount of a check can only be recovered once; (2) once the drawer is obligated to pay a statutory penalty, no other charges (other than the face amount of the check) can be recovered from the drawer; (3) only one service charge can be recovered from the drawer with respect to the same check; (4) if a service charge is recovered, all other damages are barred; and (5) a payee cannot recover a statutory penalty, and also a service charge, interest or compensation for other losses.

h. Criminal Sanctions

The liability for the statutory penalty is in addition to any criminal penalties that may be imposed.¹⁴

2. Timely Payment Avoids Statutory Penalty

The following examples illustrate the application of the Bad Check Law when the drawer makes timely payment of the returned check:

! Timely payment of \$100 check: If (a) the returned check was for \$100, (b) the payee imposed a \$15 service charge, (c) the costs to mail the written demand by certified mail totaled \$1.42 (\$.32 postage + \$1.10 fee for certified mail), and (d) the payee requested these amounts in a proper written demand sent to the drawer by certified mail, the drawer could escape liability for a statutory penalty only by paying the payee \$116.42 within 30 days of the date the payee mailed the written demand by certified mail (\$100 check + \$15 service charge + \$1.42 mailing costs).¹⁵

! Timely payment of \$10 check: If (a) the returned check was for \$10, (b) the payee

imposed a \$15 service charge, (c) the costs to mail the written demand by certified mail totaled \$1.42 (\$.32 postage + \$1.10 fee for certified mail), and (d) the payee requested these amounts in a proper written demand sent to the drawer by certified mail, the drawer could escape liability for a statutory penalty only by paying the payee \$26.42 within 30 days of the date the payee mailed the written demand by certified mail (\$10 check + \$15 service charge + \$1.42 mailing costs).¹⁶

3. Consequences of Failure to Pay Amount Demanded

The drawer's failure to make the payment required by the Bad Check Law to avoid liability for a penalty has the following consequences:

! Failure to cover \$10 check: If (a) the returned check was for \$10, (b) the payee imposed a \$15 service charge, (c) the costs to mail the written demand by certified mail totaled \$1.42 (\$.32 postage + \$1.10 fee for certified mail), (d) the payee requested these amounts (totaling \$26.42) in the mailed demand, and (e) the drawer did not pay the \$26.42 within 30 days after the demand was mailed, the drawer would be liable for \$110 (\$10 check + \$100 minimum statutory penalty).¹⁷

! Failure to cover \$100 check: If (a) the returned check was for \$100, (b) the payee imposed a \$15 service charge, (c) the costs to mail the written demand by certified mail totaled \$1.42 (\$.32 postage + \$1.10 fee for certified mail), (d) the payee requested these amounts (totaling \$116.42) in the mailed demand, and (e) the drawer did not pay the \$116.42 within 30 days after the demand was mailed, the drawer would be liable for \$400 (\$100 check + \$300 statutory penalty).¹⁸

! Failure to cover \$100 check -- \$25 timely partial payment: If (a) the returned check was for \$100, (b) the payee imposed a \$15 service charge, (c) the costs to mail the written demand by certified mail totaled \$1.42 (\$.32 postage + \$1.10 fee for certified mail), (d) the payee requested these amounts (totaling \$116.42) in the mailed demand, and (e) the drawer made a partial payment of \$25 within 30 days after the demand was mailed, but did not pay the remaining \$91.42 at any time, the drawer would be liable for \$300 (\$75 balance of check + \$225 statutory penalty).¹⁹

! Failure to cover \$100 check -- \$25 untimely partial payment: If (a) the returned

check was for \$100, (b) the payee imposed a \$15 service charge, (c) the costs to mail the written demand by certified mail totaled \$1.42 (\$.32 postage + \$1.10 fee for certified mail), (d) the payee requested these amounts (totaling \$116.42) in the mailed demand, and (e) the drawer made a partial payment of \$25 later than 30 days after the demand was mailed but before the payee files suit, but did not pay the remaining \$91.42 at any time, the drawer would be liable for \$375 (\$75 balance of check + \$300 statutory penalty).²⁰

In 1996, the Legislature eliminated a prior statutory requirement that the drawer's payment to the payee be in cash. Now, no medium of payment is specified in the Bad Check Law.²¹ While payment by cash, a cashier's check, a credit or debit card, or another check, probably meets the statute's requirements, the payee has the same option to insist on cash or its equivalent as any person who is entitled to receive payment.

A cash payment is still required by the statute in stop payment situations.²²

On occasion, a returned check is re-deposited. If the same check is again returned, only one service charge or statutory penalty is recoverable.²³

4. Written Demand: Contents, Mailing, and Evidence of Mailing

Most claims for a statutory penalty result from either lack of funds or credit in the drawer's account, or absence of an account. The rules that apply to the payee's written demand in those common situations are discussed immediately below. (If the drawer has stopped payment, special rules apply (see 5, below).)

a. Written Demand Required

A person who writes a check that is returned for lack of funds or credit, or absence of an account, is liable for a statutory penalty only if the payee has mailed the drawer a written demand for payment by certified mail.²⁴

The statute does not require that the drawer actually receive a demand for payment that is properly addressed and mailed. The address appearing on the drawer's check ordinarily would be an acceptable address unless it was not the most recent address provided by the drawer to the payee.²⁵

b. Contents of Written Demand

The contents of the written demand are prescribed by statute. The written demand must

inform the drawer of (1) "the amount of the check," (2) "the amount of the service charge payable to the payee," (3) if the payee desires to request mailing costs, the "costs to mail the written demand, and, (4) "the provisions of" the Bad Check Law.²⁶ While a literal interpretation of the statute would require the payee to replicate the entire text of the statute, that would confuse rather than inform most drawers. Hence, that would not be a sensible interpretation.

The text, context and purposes of the Bad Check Law suggest that the written demand should include a clear statement of all of the following: (1) the name of the drawer (the person who wrote the check and to whom the demand is addressed); (2) the name of the payee (the person or business to whom the check was made payable); (3) the amount of the check (its face amount); (4) the drawer's potential liability (the fact that the drawer may be liable to the payee for (a) the amount of the check, minus any partial payments made within 30 days after the payee mailed the demand for payment, plus (b) a statutory penalty equal to treble that amount, but not less than \$100 nor more than \$1,500); (5) what the drawer must do to avoid liability (the fact that the drawer will be liable for the total in (4) unless the drawer pays to the payee, at the address given in the demand for payment, within 30 days after the payee mailed the demand, the total of (a) the amount of the check, (b) the amount of the service charge payable to the payee, and (c) the costs to mail the written demand); and (6) the address of the payee (where payment can be either mailed or delivered). The demand should itemize the elements and state their total.

While the Bad Check Law provides no sample written demand for use in an "insufficient funds" situation,²⁷ the statutory form required for use in "stop payment" situations²⁸ can serve as a guide (see Appendix A, pages 9 and 10).²⁹ Generally speaking, a properly designed and transmitted demand will assure that the drawer has all of the information that the drawer needs to avoid liability for a statutory penalty.

c. Evidence of Mailing Written Demand

In order to recover a statutory penalty, the payee must demonstrate that the payee sent to the drawer by certified mail a written notice that complies with the Bad Check Law.³⁰ The payee also must offer evidence of any partial payments received, or that no partial payments were

received.³¹ The statute does not require that the drawer actually receive a written demand that was properly addressed and mailed.

Certified mail service provides the sender with a mailing receipt, and a delivery record is kept at the post office of the addressee. No record is kept at the office from which certified mail is mailed. Evidence of mailing takes the form of a Receipt for Certified Mail (PS Form 3800), which bears (1) the addressee's name and address, (2) the certified mail number, (3) a breakdown and total of the mailing costs (\$.32 postage + \$1.10 certified fee = \$1.42)³² and (4) a postmark.

In order to recover a statutory penalty, the payee need only submit a copy of the written demand and a completed and postmarked Receipt for Certified Mail (PS Form 3800). (Contrast the rule on stop payment checks, discussed at page 5 below.)³³ If the drawer did not receive the mailed demand because the address to which the payee mailed the demand was not the most recent address provided by the drawer to the payee, or if the payee failed to follow any of the other statutory requirements, the statutory prerequisites may not have been met.

5. Special Rules for "Stop Payment" Checks

a. Special Protection to Drawer of Check

Special rules apply if the drawer of a check has stopped payment.³⁴ These rules preserve the right of a drawer to stop payment for any legitimate reason.³⁵ If a drawer exercises the right to stop payment in order to resolve a good faith dispute with the payee, no statutory penalty can be imposed, even if the court later determines that the drawer is obligated to pay the obligation for which the check was given.³⁶ See e., below, for the circumstances in which a drawer has the right to stop payment.

The special rules for "stop payment" situations are discussed in the rest of this section.

b. Special Written Demand Required

The text of the demand for payment where the drawer has stopped payment is prescribed by statute.³⁷ The prescribed form is reproduced in Appendix A on page 10. This demand form is designed for situations where the drawer has stopped payment, and differs from the written demand that must be mailed in other situations (lack of funds or credit, or absence of an account). For instance, in contrast to the written demand in other situations, the drawer must pay cash. Also,

the payee must send the notice to the drawer by certified mail, but, in contrast to other situations, a return receipt must be requested.³⁸

c. Mailing and Evidence of Mailing of Special Written Demand

In order to recover a statutory penalty after payment has been stopped, the special written demand must be mailed by certified mail (return receipt requested), addressed to the drawer at "the drawer's last known address."³⁹ (At a court hearing, the payee must be able to introduce into evidence a copy of the written demand and a signed certified mail receipt showing delivery or attempted delivery.⁴⁰)

Return receipt service provides a mailer with evidence of delivery -- a Domestic Return Receipt (PS Form 3811) signed by the addressee or the addressee's agent.⁴¹ (If the addressee signs for the delivered mail, the completed and signed Domestic Return Receipt is returned to the payee, who must produce this in any court action to enforce the penalty.)

If the written demand is not accepted by the drawer, the payee must be able to provide two documents: (1) the Receipt for Certified Mail (PS Form 3800), completed to show (a) the drawee's name and address, (b) postage, (c) certified mail fee, (d) return request fee, and (e) postmark, plus (2) the unsigned Domestic Return Receipt, with evidence of the attempted delivery and the drawer's refusal to accept it.

d. Good Faith Dispute: Drawer not Liable

A drawer who acts in good faith can exercise his or her right to stop payment without incurring the risk of liability for the statutory penalty, a service charge or mailing costs. Even if it turns out that the drawer was obligated to make the payment for which the check was given, the payee cannot recover a service charge, mailing costs or statutory penalty, if the drawer stopped payment in good faith. In that event, the court might award the payee the face amount of the check and any allowable damages, such as prejudgment interest (if there is no defense to payment).

e. "Good Faith Dispute" Defined

A "good faith dispute" is one in which the court finds that the drawer had "a reasonable belief of his or her legal entitlement to withhold payment."⁴² The statute states that "[g]rounds for the entitlement include, but are not limited to, the following: services were not rendered, goods were not delivered, goods or services purchased

are faulty, not as promised, or otherwise unsatisfactory, or there was an overcharge."⁴³

The existence of a "good faith dispute" is "determined by the trier of fact" (in small claims court, the judge).⁴⁴ It is an issue of fact, not law.

f. Evidence of Lack of Good Faith Dispute

If the drawer has stopped payment, the payee must prove, by clear and convincing evidence, that there was no good faith dispute in order to recover a service charge and costs to mail the written demand, or statutory penalty.

The payee must prove a negative -- the absence of a good faith dispute -- and must prove it by clear and convincing evidence. Hence, any reasonable doubt about whether the dispute was in fact a good faith dispute is resolved in favor of the drawer. On the other hand, a stop payment order that was not made in the context of a real dispute regarding the underlying obligation or its amount -- for instance, a stop payment done simply to try to avoid paying for goods or services purchased -- would not qualify for the exemption from a statutory penalty.

As explained in the next subdivision, the payee also must make and provide evidence of reasonable efforts to resolve the dispute informally.

g. Informal Settlement Efforts Required of Payee

A payee who plans to seek a court judgment for a statutory penalty in a stop payment situation must attempt to reconcile and resolve the dispute before filing the action.⁴⁵ If the drawer has stopped payment, it is not sufficient for the payee just to mail the drawer a written demand. The payee must reach out to the drawer and make a good faith effort to attempt to resolve the problem. The statute urges the drawer to contact the payee to try to resolve the dispute.⁴⁶

In any court action, the payee must be able to produce evidence of the payee's settlement efforts. The payee must "show to the satisfaction of the trier of fact that [the payee made] . . . a reasonable effort . . . to reconcile and resolve the dispute prior to pursuing the dispute through the courts."⁴⁷ The payee must be prepared to describe what settlement efforts were made, apart from sending the prescribed notice.

7. Claim by Government Payee

See Appendix B, pages 10 and 11.

8. Court Action to Recover Statutory Penalty

The original payee of a check that is returned for insufficient funds can file a claim for damages in the small claims court if the total amount of the claim does not exceed the small claims court's jurisdictional limit.⁴⁸ A claim for damages alternatively may be filed in any other court having jurisdiction.

a. Inquiry by Judge

At the outset of a small claims court action in which a plaintiff (payee) is asserting a claim for a statutory penalty against the defendant (drawer), the judge ordinarily will first ask the plaintiff for a copy of the written demand for payment, as well as evidence of its mailing by certified mail. If there is no proper written demand for payment, or no evidence that the written demand was mailed by certified mail, the plaintiff has no right to a statutory penalty under the Bad Check Law.⁴⁹

Ordinarily, if these documents are not available for submission to the judge, the claim for a statutory penalty will be dismissed or the hearing on that claim will be postponed. However, judgment for the face amount of the check and other allowable damages (e.g., prejudgment interest (see page 8)) can still be awarded without a new court action, provided that the drawer does not establish a defense to payment (see pages 8-9).

b. Judgment

If the payee has mailed the required written demand by certified mail, and the drawer has not paid the payee the payment necessary to avoid liability for a statutory penalty within 30 days after the demand was mailed, the payee can recover the face amount of the check, and a statutory penalty.⁵⁰

c. Statutes of Limitations

The following limitation periods apply, after which a court action cannot be filed: (1) action to enforce the drawer's obligation to pay the face amount of a returned check -- three years;⁵¹ (2) action to enforce a statutory service charge -- three years;⁵² and, (3) action to enforce a statutory penalty -- one year.⁵³

d. Judicial Discretion

The court's discretion in administering a statutory penalty award has certain limits. The Legislature has declared that "[t]he requirements of [the Bad Check Law] in regard to remedies are

mandatory upon a court."⁵⁴ This reflects the key legislative purpose of the statute -- to deter the writing of a check on a bank account that has insufficient funds on deposit to pay it. As one court has said, "[t]he manifest purpose of [the Bad Check Law] is to discourage the issuance of bank checks, drafts or orders when the drawer's funds are insufficient. By increasing the stakes for a defendant it serves as a statutory incentive to refrain from the writing of bad checks."⁵⁵

While the court cannot decline to award a penalty if the payee is legally entitled to it, the Bad Check Law⁵⁶ does not impose strict liability on the drawer of a check. The drawer can assert the same legal defenses against the payee that can be asserted in other simple contract actions. (See discussion of drawer's defenses, pages 8-9.)

e. Assignment of Payee's Claim for Damages

Only the original payee of a returned check can file in small claims court to recover the face amount of a check and a statutory penalty under the Bad Check Law.⁵⁷ However, the payee may transfer or assign a claim under the Bad Check Law,⁵⁸ and the transferee or assignee may file an action under the Bad Check Law in municipal or justice court.⁵⁹

C

CLAIM FOR SERVICE CHARGE

a. General Rule

The Bad Check Law also provides for the recovery of a service charge in certain situations (see page 1).

Only one service charge is recoverable with respect to the same check.⁶⁰ The right to a service charge is lost once the payee becomes entitled to a penalty after mailing a demand under the Bad Check Law.⁶¹

b. When Statutory Service Charge Cannot be Imposed

The Legislature has declared that the drawer of the check is not liable for a service charge in any of the situations listed on page 1.

c. Advance Disclosure of Amount of Service Charge

The Bad Check Law sets an upper limit on the amount of the service charge that the payee may charge when the drawer's check is returned for insufficient funds. However, the Bad Check Law does not require that the payee to inform the drawer of the existence or the amount of the service charge before the drawer writes the check.

While the statute does not explicitly require advance notice of the fact or the amount of the service charge, the Legislature may have contemplated that prevailing practices would continue -- that is, that buyers would be informed by signs at retailers' cash registers or in contract disclosures that a specific amount will be charged for returned checks -- so that consumers can enter into transactions knowingly and decline to patronize retailers whose charges seem high. While the Legislature's expectation would not create a statutory obligation to give advance notice, it might influence the application of other existing laws.

d. Service Charge is Now Statute-Based

The new statute-based service charge apparently replaces the traditional contract-based service charge, the validity of which was challenged in Newman v. Checkrite California, Inc.⁶² In that case, the drawer argued that the posting of a retailer's service charge policy did not result in an agreement to pay the service charge. While the legislative intent is not clear and the Bad Check Law is ambiguous on many points, the 1996 revision to the law seems to have made the right to impose a service charge statute-based rather than contract-based, and also to cap the amount of any agreed service charge or similar damage claim.

The purpose of the traditional service charge for returned checks was to compensate the retailer for the resulting losses, such as delay in receiving payment, any returned check fee paid to the retailer's bank, and the inconvenience and added expense of processing the returned check. Most retailers still follow past practice, and notify customers making purchases and paying by check that a service charge will be imposed if a check is returned for insufficient funds. That usually is accomplished by a prominent sign at retailers' cash registers, or by clauses in order forms or other written contracts between retailers and customers.

The posting of a returned check policy, or an order form or some other agreement, still may technically result in a contract-based service charge. However, the 1996 version of the Bad Check Law⁶³ seems to limit the amount of the agreed service charge regardless of its characterization. For the reasons given in subsection e., a payee should not be able to recover both the statute-based service charge and a service charge based on the parties' agreement.

e. Double Recoveries Barred

The payee's statutory right to a service charge for a returned check⁶⁴ is part of a statutory scheme, adopted in 1996,⁶⁵ in which drawers who fail to pay the amount of the returned check, the amount of the service charge, and the costs of mailing a written demand for payment, become obligated to pay the amount of the check plus a statutory penalty. Just as the payee of a check cannot recover both the face amount of the check and the underlying obligation,⁶⁶ the payee of a check who imposes a statutory service charge is barred from seeking duplicate recoveries on the following grounds:

- ! New statutory remedy is exclusive: The effect of the 1996 revision was to give the payee a new statutory right (to receive a check whose return would give rise to a statutory service charge) and a new statutory remedy (court enforcement of the service charge). The courts have declared that unless the Legislature has declared otherwise, a new statutory remedy is exclusive, and other remedies are barred.⁶⁷
- ! "Compensatory damages": Damages only compensate for loss and must be reasonable; a plaintiff cannot profit from a breach, and forfeitures and penalties are disallowed. "The general theory of compensatory damages bars double recovery for the same wrong."⁶⁸ The statutory service charge is a successor to and has the same functions as the traditional service charge. Hence, allowing a payee who seeks a statute-based service charge to also recover an agreed service charge, or damages for any of the other losses for which the traditional service charge may have served as compensation (e.g., prejudgment interest, the payee's own returned check fee, etc.), would result in double recoveries for the same loss, which is not permitted.
- ! Liquidated damages merger: If the parties to a check transaction agree that the drawer will pay a service charge in the event the drawer's check is returned, that agreement may constitute a liquidation of damages,⁶⁹ as a result of which other damages claims are merged in the agreed charge.
- ! Cumulative remedies not intended: Where the Legislature intends to create civil remedies that are cumulative and not exclusive, it typically says so.⁷⁰ There is no such expression in the statute governing actions for damages involving returned checks.

D

CLAIM FOR PREJUDGMENT INTEREST

a. Right to Prejudgment Interest

The measure of damages for breach of an obligation to pay money only is "the amount due by the terms of the obligation, with interest thereon."⁷¹ Therefore, the payee of a check that is returned unpaid has a right to prejudgment interest from the date of the check until the check is paid.⁷² Unless otherwise agreed, interest accrues at the rate of 10 percent per annum.⁷³

b. When Interest Begins to Accrue

The obligation of the drawer of a check is a primary obligation, which is defined by the check's "terms at the time it was issued"⁷⁴ Since notice of dishonor or protest is not a prerequisite to the drawer's liability, interest ordinarily accrues on a check from the date of the check.⁷⁵

c. When Prejudgment Interest Not Available

Interest is a form of damages. Hence, if there is a valid liquidated damages agreement between the drawer and payee, the payee's claims for prejudgment interest and any other losses are merged in the agreed damages, and are no longer recoverable separately.⁷⁶

The imposition of a service charge for a returned check may also bar recovery of prejudgment interest on the unpaid check, on the basis that it would result in a double recovery of damages (see page 7).

E

CLAIM FOR FACE AMOUNT OF CHECK

a. Bases for Payee's Claim

The Commercial Code gives the payee of a check returned by the bank for insufficient funds the right to enforce the check against the drawer.⁷⁷ A right to recover the face amount of a check returned for insufficient funds also is conferred by the Bad Check Law.⁷⁸

A payee who can assert a claim based on a returned check⁷⁹ also may have an alternative claim based on the obligation for which the check was given in payment (e.g., the price of a sale of goods or services).⁸⁰

As explained at c., below, double recoveries are barred.

b. All "Simple Contract" Defenses Assertable

The drawer of a check may be able to establish the unenforceability of the underlying obligation, and, hence, the check, by asserting both "real" and "personal" defenses (see part F., below).

c. Double Recoveries Barred

While a payee can sue on both (1) the check⁸¹ and (2) the underlying claim, judgment can be given only on one theory or law, not both. There are three independent bases for this conclusion:

- ! If the check is dishonored, the law provides that the payee "may enforce either the instrument or the obligation"⁸²
- ! Damages only compensate for a loss and must be reasonable; a plaintiff (the payee) cannot profit from a breach, and forfeitures and penalties are disallowed. "The general theory of compensatory damages bars double recovery for the same wrong."⁸³
- ! Where the Legislature intends to create civil remedies that are cumulative and not exclusive, it typically says so.⁸⁴ There is no such expression in the law governing actions for damages involving returned checks.

F

DRAWER-S DEFENSES TO PAYMENT

a. Is the Payee a "Holder" or a "Holder in Due Course"?

A payee who has received a check and who still holds it is called a Holder. A holder of a check can enforce it in court.⁸⁵ A person to whom the payee assigns or transfers the check is also a Holder. However, the person to whom the payee assigns or transfers the check may also qualify as a "holder in due course" (defined in endnote 86).⁸⁶ Whether the transferee of a check is a "holder" or a "holder in due course" determines what kinds of defenses the drawer can assert against the transferee's claim against the drawer for payment.

A holder in due course has greater rights to enforce payment of the check against the drawer than does a holder who is not a holder in due course. A holder who is also a holder in due course is said to take the check free of the "personal" defenses (see subsection b., below) that a drawer might assert against the original payee (or against some other holder who is not a Holder-in-due-course).

b. Drawer Can Assert "Personal" Defenses Against a Holder

The drawer can assert a broad array of defenses, called personal defenses against a holder -- such as the original payee -- who does not qualify as a holder in due course (see endnote 86). In legal terminology, a holder's right to enforce the obligation to pay an instrument is subject to "a defense of the [drawer] that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract."⁸⁷

This means that the holder's right to enforce payment is also subject to "simple contract defenses," such as fraud in the inducement, misrepresentation, failure or lack of consideration, unconscionability, or breach of warranty. While the drawer can assert these so-called "personal" defenses against a holder, the drawer cannot assert them against a holder in due course.

c. Drawer Can Assert Only "Real" Defenses Against a Holder in Due Course

A holder who is a holder in due course is subject to fewer kinds of defenses than a holder who is not a holder in due course. Nonetheless, a holder in due course is subject to the defenses of: "(A) infancy of the [drawer] to the extent it is a defense to a simple contract, (B) duress, lack of legal capacity, or illegality ..., (C) fraud that induced the [drawer] to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (D) discharge of the [drawer] in insolvency proceedings."⁸⁸

d. Drawer's "Article Three" Defenses

A holder's right to enforcement also is subject to "[a] defense of the [drawer] stated in [Article Three of the Uniform Commercial Code]."⁸⁹ These defenses include:⁹⁰ non-issuance of the instrument, conditional issuance, and issuance for a special purpose;⁹¹ modification of the obligation by a separate agreement;⁹² payment that violates a restrictive endorsement;⁹³ and, issuance without consideration or when promised consideration has not been given.⁹⁴

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NOTICE: We attempt to make our Legal

Guides accurate as of the date of publication, but they are only guidelines and not definitive statements of the law. Questions about the law's application to particular cases should be directed to a specialist.

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ENDNOTES

1. Civil Code ' 1719, as amended by Stats. 1996, ch. 1000 (AB 2643).
2. Civil Code ' 1719(a)(1),(2).
3. Civil Code ' 1719(a)(1).
4. Civil Code ' 1719(a)(4).
5. Civil Code ' 1719(a)(5).
6. Civil Code ' 1719(a)(1),(2).
7. Civil Code ' 1719(a)(2).
8. Civil Code ' 1719(j)(2).
9. Civil Code ' 1719(a)(6).
10. Civil Code ' 1719(a)(6).
11. Civil Code ' 1719(a)(2).
12. Civil Code ' 1719(a)(2).
13. Civil Code ' 1719(a)(2).
14. Civil Code ' ' 1719(a)(1),(2).
15. Civil Code ' 1719(a)(2).
16. Civil Code ' 1719(a)(2).
17. Civil Code ' 1719(a)(2).
18. Civil Code ' 1719(a)(2).
19. Civil Code ' 1719(a)(2).
20. Civil Code ' 1719(a)(2).
21. Civil Code ' 1719(a)(2).
22. Civil Code ' 1719(c).
23. Civil Code ' 1719(j)(2).
24. Civil Code ' ' 1719(a)(2), (j)(1).
25. See Civil Code ' 1719(d).
26. Civil Code ' 1719(a)(2).
27. See Civil Code ' 1719.
28. See Civil Code ' 1719(c).
29. This is the advice given in California Forms of Pleading and Practice, at Negotiable Instruments, Form 60, Comments.
30. Specifically, Civil Code ' 1719(a)(2).
31. Civil Code ' ' 1719(a)(2), (j)(1).
32. As of July, 1995.
33. Civil Code ' 1719(d), discussed below.
34. Civil Code ' ' 1719(a)(3),(b),(c),(d) and (e).
35. Civil Code ' ' 1719(a)(3),(b),(c),(d) and (e).
36. Civil Code ' 1719(a)(3).
37. Civil Code ' 1719(c).
38. Civil Code ' 1719(d).
39. Civil Code ' 1719(d).
40. Civil Code ' 1719(d).
41. The additional charge for a return receipt showing to whom delivered, and when, is \$1.50, increasing the total mailing costs (as of 1996) to \$2.92 (\$.32 Postage + \$1.10 certified mail fee + \$1.50 return receipt fee).
42. Civil Code ' 1719(b).
43. Civil Code ' 1719(b).
44. Civil Code ' 1719(b).
45. Civil Code ' 1719(e).
46. Civil Code ' 1719(b).
47. Civil Code ' 1719(e).
48. Civil Code ' 1719(e).
49. Civil Code ' 1719(j)(1).
50. Civil Code ' 1719(a)(2),(e).
51. Commercial Code ' 3118(c).
52. Code of Civil Procedure ' 338(a).
53. Code of Civil Procedure ' 340(1).
54. Civil Code ' 1719(h). When the Legislature increased the maximum penalty from \$500 to \$1,500 in 1995, it declared: "The number of checks passed on insufficient funds, and the amounts of those checks, are increasing. Thus, the number of disputes taken to small claims court has increased. In enacting [the 1995 changes (Stats. 1995, ch. 134 (AB 522))⁹⁵], the Legislature intends to deter any further expansion of the number of incidents of passing checks on insufficient funds, and thereby reduce the burden on small claims courts."⁹⁶ (Stats. 1995, ch. 134, ' 2.)
55. Mughrabi v. Suzuki (1988) 197 Cal.App.3d 1212 [243 Cal.Rptr. 438,440].
56. Civil Code ' 1719(a)(2).
57. Civil Code ' 1719(e).
58. Civil Code ' 1719(i). If the claim is transferred or assigned to a debt collection agency, the collection agency must file in superior, municipal or justice court. The debt collector must give the payee the amount of the penalty recovered in excess of the debt collector's flat charge. (Civil Code ' 1719(f).)

59. Civil Code ' 1719(f).
60. Civil Code ' 1719(j)(2).
61. Civil Code ' 1719(a)(2).
62. Newman v. Checkrite California, Inc. (E.D. Cal., 1995) 912 F. Supp. 1354, 1359.
63. At Civil Code ' 1719(a)(1).
64. At Civil Code ' 1719(a)(1).
65. Stats. 1996, ch. 1000 (AB 2643).
66. Commercial Code ' 3301(b)(3); see White & Summers, Uniform Commercial Code (4th ed. 1995), ' 16-14, p.135.
67. "[W]hen a new right has been created by statute, and a statutory remedy for its infringement is provided, the statutory remedy is exclusive and no other remedy will be allowed." (3 Witkin, Cal. Proc. (4th ed. 1996) Actions, ' 7 (citations; emphasis in original.)
68. 6 Witkin, Sum. of Cal. Law (9th ed. 1988) Torts, ' 1322; see Greater Westchester Homeowners Assn. v. Los Angeles (1979) 26 Cal.3d 86, 103 [160 Cal.Rptr. 733, 741].
69. Civil Code ' 1671.
70. See, e.g., Civil Code ' 1752.
71. Civil Code ' 3302
72. Civil Code ' 3287(a).
73. Civil Code ' 3289(b).
74. Commercial Code ' 3414(b)(1).
75. See Com. Code ' 3414, Official Comment 2; 3 Witkin, Sum. of Cal. Law (9th ed. 1987) Negotiable Instruments, 1995 Supp. ' 235.
76. Civil Code ' 1671.
77. Com. Code ' 3414(b)(1); see 2 White & Summers, Uniform Commercial Code (4th ed. 1995), ' 16-6(a).
78. Civil Code ' 1719(a)(1).
79. Under Commercial Code ' 3414.
80. See Commercial Code ' ' 2708, 2709, 2730; 4 Witkin, Cal.Proc. (3d ed. 1985) Pleading, ' ' 504-506.
81. Under either Com. Code ' 3414(b)(1) or Civil Code ' 1719(a)(1).
82. Commercial Code ' 3310(b)(3); see White & Summers, Uniform Commercial Code (4th ed. 1995), ' 16-14, p. 135.
83. 6 Witkin, Sum. of Cal. Law (9th ed. 1988) Torts, ' 1322; see Greater Westchester Homeowners Assn. v. Los Angeles (1979) 26 Cal.3d 86, 103 [160 Cal.Rptr. 733, 741].
84. For instance, Civil Code ' 1752 declares that the remedies of the Consumers Legal Remedies Act are non-exclusive.
85. When the drawer of a check issues the check to the payee, the payee becomes the "holder" of the check.

(Commercial Code ' 3105(a); Commercial Code ' 3201, Official Comment 1.

86. A "holder in due course" is the holder of a check (or other instrument) that appears to be authentic, who has taken the instrument from another for value, in good faith, without notice that the check has been dishonored, and without notice of other defects in the check (e.g., without notice that the check contains an unauthorized signature). (Commercial Code ' 3302(a).) Examples of a holder in due course include the bank where the payee of a check deposits it, and a grocery store that cashes a payroll check for a customer who is the payee of the check. (See White & Summers, Uniform Commercial Code (4th ed. 1995), ch. 17; 3 Witkin, Sum. of Cal. Law (9th ed. 1987) Negotiable Instruments, ' ' 75-83.) In a typical two-party check situation, the payee is the holder of the check. Technically, the payee of the check can also be a holder in due course. However, the holder in due course doctrine "... applies only to cases in which more than two parties are involved,"⁹⁷ (Commercial Code ' 3305, Official Comment 2), and therefore is "irrelevant" in determining the rights between the two parties in a typical two-party check situation (see 2 White & Summers, Uniform Commercial Code (4th ed. 1995), ' 17-8, pp. 178-179 ("a typical drawer of a check can always assert its defense against its own payee...."); see 3 Witkin, Sum. of Cal. Law (9th ed. 1987) Negotiable Instruments, ' 75(b)).

87. Commercial Code ' 3305(a)(2); see this section and Official Comment 2 for details; 3 Witkin, Sum. of Cal. Law (9th ed. 1987) Negotiable Instruments, ' 72; 2 White & Summers, Uniform Commercial Code (4th ed. 1995), ' 17-10.

88. Commercial Code ' 3305(a)(1).

89. Commercial Code ' 3305(a)(2).

90. See Com. Code ' 3305, Official Comment 2.

91. Commercial Code ' 3105(b).

92. Commercial Code ' 3117.

93. Commercial Code ' 3206(f).

94. Commercial Code ' 3303(b).

95. Civil Code ' 1719, as amended by Stats. 1996, ch. 1000.

96. The person or business to whom the check is made out is said to be the Apayee of the check.

97. Commercial Code ' 3305, Official Comment 2).

APPENDIX A
Payee's Notice to Drawer in
Stop-Payment Situations
Notice

To: _____
(name of drawer)

_____ is the
(name of payee)

payee of a check you wrote for \$ _____.
(amount)

The check was not paid because you stopped payment, and the payee demands payment. You may have a good faith dispute as to whether you owe the full amount. If you do not have a good faith dispute with the payee and fail to pay the payee the full amount of the check in cash, a service charge of an amount not to exceed twenty-five dollars (\$25) for the first check passed on insufficient funds and an amount not to exceed thirty-five dollars (\$35) for each subsequent check passed on insufficient funds, and the costs to mail this notice with 30 days after this notice was mailed, you could be sued and held responsible to pay at least both of the following:

- (1) The amount of the check.
- (2) Damages of at least one hundred dollars (\$100) or, if higher, three times the amount of the check up to one thousand five hundred dollars (\$1,500).

If the court determines that you do have a good faith dispute with the payee, you will not have to pay the service charge, treble damages, or mailing cost. If you stopped payment because you have a good faith dispute with the payee, you should try to work out your dispute with the payee. You can contact the payee at:

_____ (name of payee)
_____ (street address)
_____ (telephone number)

You may wish to contact a lawyer to discuss your legal rights and responsibilities.

(name of sender of notice)

[Civil Code ' 1719(c).]

APPENDIX B

Claim by Government Payee

The State of California, and each city and other government agency, may accept personal checks in payment for any license, permit, or fee, or in payment of any obligation owing to the public agency or trust deposit. (Gov. Code ' 6157 (a).) If a personal check offered in payment under this section is returned without payment for any reason, the public agency may impose a reasonable charge for the returned check to recover the public agency's processing and collection costs. This charge may not exceed the actual costs incurred by the public agency. (Gov. Code ' 6157 (b).) This charge is the economic equivalent of the service charge routinely assessed by retailers, but is based solely on statute, not contract.

The Bad Check Law does not limit its applicability to particular classes of payee, there is no reason that the statutory penalty that it authorizes is not recoverable by a government agency that meets the statute's prerequisites.

Special rules govern the contents and mailing of the demand for payment which is given by a municipal court payee as a prerequisite for the municipal court's claim for a statutory penalty under the Bad Check Law. (See Civil Code ' 1719 (g).)

APPENDIX C

TABLE

Check Drawer's Obligations and Options

At Successive Stages After Drawer's Check is Returned

(Assuming all Statutory Prerequisites are Met)

STAGE OF THE TRANSACTION (A Day X@ = Date of check payee's written demand.)	STAGE I (Day 0 to Day X) After drawer assents to payee's policy on service charges, drawer gives payee the check in payment. Check is returned to payee by payee's bank for insufficient funds. Drawer owes the payee:	STAGE II (Day X to Day X+30) Payee has mailed drawer a written demand for payment by certified mail. In order to avoid a statutory penalty, drawer must pay the payee, within 30 days:	STAGE III (After Day X + 30) 30 days have expired after the written demand was mailed, and drawer has not fully paid the face amount of the check, service charge, and mailing costs. Drawer owes payee:
CHECK DRAWER MUST PAY AMOUNT BELOW:			
FACE AMOUNT OF CHECK	Yes	Yes	Yes
SERVICE CHARGE	Yes	Yes	No
MAILING COSTS	No	Yes	No
STATUTORY PENALTY	No	No	Yes